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In the Supreme Court of the United States

OCTOBER TERM, 1973

JULIO, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The Memorandum Findings of Fact and Opinion of the Tax Court (Pet. App. 15a-19a) are unofficially reported at 30 T.C.M. 284. The opinion of the court of appeals (Pet. App. 5a-14a) is reported at 483 F. 2d 47.

JURISDICTION

The judgment of the court of appeals was entered on June 27, 1973. The petition for a writ of certiorari was filed on September 17, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether real property which is not a capital asset because it is held primarily for sale to customers in the ordinary course of business automatically becomes a capital asset upon the owner's receipt of a notice of condemnation of the property.

STATUTES INVOLVED

Sections 1201, 1221, and 1222 of the Internal Revenue Code of 1954 are set forth at Pet. App. 3a-4a.

STATEMENT

Petitioner is a New Jersey corporation organized in 1954 for the purpose of real estate development, home building, and sales. During 1955, petitioner purchased a 100-acre tract of land for the purpose of development and sale, and shortly thereafter began developing the tract. The Tax Court found, and petitioner does not now dispute, that the 100-acre tract of land became part of petitioner's inventory as a real estate dealer as property held primarily for sale to customers in the ordinary course of its trade or business within the meaning of Section 1221(1) of the Code (Pet. App. 15a-16a).

In 1958, petitioner informally learned that the State of New Jersey planned to condemn approximately 16 acres of the 100-acre tract for use in the construction of a highway. The state thereafter formally condemned the property, and after negotiations, it made a final award in 1965 to petitioner of $50,000. Petitioner appealed this award to a state court, which entered judgment in its favor in the amount of $97,650.63 for 16.5 acres of condemned land. Petitioner's appeal from the initial award of $50,000 was based on the premise that the condemnation would damage potential commercial property as well as potential residential property. The condemnation was consummated on January 7, 1966 (Pet. App. 17a).

As a result of the condemnation, petitioner realized a gain of $70,950.30. On its federal income tax return for its taxable year ended October 31, 1966, petitioner reported this amount as a capital gain. Upon examination of the return, the Commissioner of Internal Revenue determined that the gain realized upon condemnation of the 16.5 acres was taxable as ordinary income because petitioner held the land primarily for sale to customers in the ordinary course of its trade or business. Under such circumstances, the land was not a capital asset.

The Tax Court set aside the Commissioner's determination, concluding that once petitioner received notice of the proposed condemnation, it no longer held the land primarily for sale to customers because the notice converted the character of the property to that of a capital asset. In so holding, the Tax Court considered its prior decision in *Tri-S Corp.* v. *Commissioner,* 48 T.C. 316, affirmed on another ground, 400 F. 2d 862 (C.A. 10), to be determinative of the question (Pet. App. 17a-19a). On the government's appeal, the Third Circuit reversed, with one judge dissenting. The majority held that a condemnation notice does not of itself convert land held primarily for sale to customers in the ordinary course of business into a capital asset (Pet. App. 5a-14a).

ARGUMENT

1. Section 1221 of the Internal Revenue Code defines the term "capital asset" negatively by providing five exclusions from the definition. The first statutory exclusion states that a capital asset shall not include "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

Petitioner does not challenge the Tax Court's finding (Pet. App. 16a) that prior to receipt of the notice of condemnation it acquired and held the land primarily for sale to customers in the ordinary course of its business. The Tax Court, however, held that the notice of condemnation automatically converted the property into a capital asset so that the gain petitioner realized upon condemnation was taxable as capital gain. The Third Circuit properly rejected that theory, holding that land that was held initially for sale to customers in the ordinary course of business did not cease to be such after the owner received a notice of condemnation. The only function of the notice of condemnation was to begin the process by which petitioner's ownership would be terminated. See, *e.g.*, *Stockton Harbor Indus. Co.* v. *Commissioner*, 216 F. 2d 638 (C.A. 9).

2. Contrary to petitioner's argument (Pet. 5-6), there is no conflict between the decision below and that of the Tenth Circuit in *Commissioner* v. *Tri-S Corp.*, 400 F. 2d 862, affirming on another ground 48 T.C. 316. There, the Tax Court held that land which was held primarily for sale to customers in the ordinary course of the taxpayer's business automatically ceased to be so held after receipt of a condemnation notice. However, as the court of appeals here correctly recognized (Pet. App. 7a), the Tenth Circuit did not affirm *Tri-S* on the theory of the Tax Court. To the contrary, it sustained the taxpayer's claim to capital gains treatment on the sole ground that the taxpayer held the land for investment before receipt of the notice of condemnation, and therefore it had never held the property for sale to customers in the ordinary course of its trade or business.

Similarly, there is no conflict with the decision of the Fifth Circuit in *Ridgewood Land Co.* v. *Commissioner*, 477 F. 2d 135, affirming *per curiam* 31 T.C.M. 39 (Pet. 5-6). There, the Tax Court upheld capital gains treatment on two independent grounds. First, in conformity with its *Tri-S* holding, it concluded that a notice of condemnation automatically changed the character of property held primarily for sale to customers to that of a capital asset. Secondly, it found that when the taxpayer learned of the state's intention to institute eminent domain proceedings, it changed its original purpose with respect to the property and thereafter held it for investment. As a result, the gain from a subsequent sale, which was made to a third party and not to the condemning governmental authority, was held to be taxable as capital gain.

The Fifth Circuit affirmed. By underscoring the phrase "under the particular facts of the case" and setting forth the Tax Court's finding concerning the taxpayer's change of purpose, the Fifth Circuit's *per curiam* opinion emphasized the restricted scope of its holding. Since the Fifth Circuit's opinion does not cite the Tax Court's *Tri-S* decision, there is no basis for petitioner's assertion of a conflict between the decision below and *Ridgewood*.

In short, neither the Tenth nor the Fifth Circuit has adopted the rationale of the Tax Court's *Tri-S* holding, rejected by the court of appeals below, that a notice of condemnation of itself automatically changes the character of property held primarily for sale to customers in the ordinary course of business to a capital asset. There is therefore no conflict among the circuits.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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